

TEXACO INC.

IBLA 94-729

Decided January 28, 1997

Appeal from a decision of the Acting Deputy Commissioner, Bureau of Indian Affairs, denying an appeal of an order of the Minerals Management Service directing recalculation and payment of additional royalties due on Navajo Allottee oil and gas lease No. 525-005595-0. MMS-91-0012-IND.

Affirmed.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties—Indians: Mineral Resources: Oil and Gas: Royalties—Oil and Gas Leases: Royalties: Payments

MMS properly required the lessee of a Federal Indian allottee oil and gas lease to review royalty accounts, to compute and pay additional royalties, and to prepare and submit supporting documentation where an MMS audit revealed anomalies in the making of royalty payments during the period at issue.

APPEARANCES: Nanette J. Crawford, Esq., Denver, Colorado, for appellant; Peter J. Schaumberg, Esq., Geoffrey Heath, Esq., Howard W. Chalker, Esq., and Sarah L. Inderbitzin, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE HUGHES

Texaco, Inc., and Texaco Exploration and Production, Inc. ("Texaco"), have appealed from a March 18, 1994, decision of the Acting Deputy Commissioner, Bureau of Indian Affairs, denying its appeal of a September 27, 1990, order of the Houston Regional Compliance Office, Minerals Management Service (MMS). The MMS order directed Texaco to recalculate and pay additional royalties for Navajo Allottee Lease No. 525-005595-0, located in Sandoval County, New Mexico, for the period September 1984 through the present.

In the September 27, 1990, order, MMS stated that an audit of the sales quantities reported by Texaco for natural gas produced from the lease during the period January 1981 through December 1986 had disclosed consistent understatements of those quantities during the period September 1984 through December 1986. MMS indicated that the review had also uncovered underpaid royalties for April and June 1986 due to the application of incorrect royalty rates and unusual fluctuations in reported gas prices during the review period.

MMS explained that its conclusion that the monthly gas volumes had been consistently understated derived from the reintegration of [Texaco's] meter charts for five months of the audit period and examination of the company's production and sales records. In addition, discussion with [Texaco] personnel disclosed that an error in the "temperature base factor" used in calculating production attributed [sic] to an understatement of approximately 90 percent of the stated volumes for 20 months. Based on the understatement of volumes, the erroneous application of royalty rates and inconsistent gas pricing, we conclude that royalties have been underpaid on the lease.

(Order at 1).

MMS stated that it had advised Texaco of the results of the audit in an August 17, 1989, letter. That letter included a schedule reflecting the understated volumes for 5 months, as determined by comparing Texaco's volumes with those reported by a contract integrator. Although MMS received a check from Texaco on January 9, 1990, in the amount of \$5,040.86, the Form MMS-2014 accompanying the payment indicated that the payment resolved only part of the issues addressed in the August 17, 1989, letter. MMS contacted Texaco personnel, who confirmed that the remittance only redressed the "temperature base factor" misstatement for the period September 1984 through May 1986.

Based on its findings that gas volumes had been understated, erroneous royalty rates applied, and inconsistent gas prices utilized, MMS directed Texaco to recalculate royalties correctly from September 1984 through the present and pay any additional royalties due. MMS also ordered Texaco to submit copies of all workpapers and schedules, including Forms MMS-2014, evidencing compliance with the order, and to retain all supporting calculations and source documents pending completion of MMS' follow-up compliance testing.

In its appeal of the September 27, 1990, order, Texaco argued that MMS had no authority to require Texaco to conduct what Texaco characterized as a "self-audit" or to order Texaco to reconstruct its records and generate new records not previously required. Texaco further denied the existence of any systemic error justifying MMS' demands.

The Acting Deputy Commissioner denied the appeal, ruling that MMS had ample authority to issue its order requiring Texaco to recalculate and pay additional royalties found to be due on the lease, a process he termed a "restructured accounting." MMS' order arose from the lessee's obligation to properly pay and report royalties, the Acting Deputy Commissioner stated, since MMS required a royalty payor to review and identify other payment errors only after first determining that the lessee had made payment errors that were likely to have been perpetuated in other months. He held that the review and correction procedure was not an audit, adding that MMS had already performed the audit or review that had uncovered patterns of noncompliance. The MMS order, he explained, simply required

Texaco to take corrective action to remedy the irregularities previously discovered by locating accounting transactions meeting specifically identified conditions and then making certain directed corrections.

The Acting Deputy Commissioner found that the MMS review of the royalty reports Texaco had submitted for the lease had revealed consistent understatements of gas quantities for the period September 1984 through December 1986, and that the existence of such an irregularity in royalty reporting and/or payment justified further inquiry into the existence of similar errors in other months. He rejected Texaco's assertions that, apart from the errors caused by the use of a "temperature base factor" (which had been corrected), no pattern of error sufficient to support MMS' order existed. He pointed out that the understatement of sales volumes was not wholly attributable to those errors, that other systemic errors appeared to account for as much as 10 percent of the understated quantities, and that no corrections or adjustments had been made for the months after May 1986 despite MMS' discovery of understatements throughout the September 1984 through December 1986 period.

The Acting Deputy Commissioner further specified that Texaco's application of a royalty rate of 12-1/2 percent, instead of the 16-2/3 percent specified in the lease, for the months of April and June 1986 supported MMS' royalty recalculation order, as did the fluctuation in Texaco's reported gas prices. The detection of anomalies in royalty reporting, he stated, provided ample foundation for an investigation into the possible occurrence of similar errors. The Acting Deputy Commissioner concluded that the systemic errors in royalty calculation and payment related to the reported quantities identified by MMS had likely affected royalty payments for production from the lease, and that MMS had therefore properly directed Texaco to review and correct its royalty payments.

In its appeal to the Board, Texaco essentially reiterates the arguments raised before the Acting Deputy Commissioner. Texaco also contends that neither the royalty rate error, which occurred in only 2 months and was corrected, nor the gas price inconsistency, which reflected economic forces not royalty calculation errors, rises to the level of a systemic error.

The Board and the courts have previously addressed the issues presented in Texaco's appeal.

[1] Section 101(c)(1) of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), 30 U.S.C. § 1711(c)(1) (1994), requires the Secretary of the Interior and his designated delegates to "audit and reconcile, to the extent practicable, all current and past lease accounts for leases of oil or gas." See also 30 CFR 217.50. In enacting FOGRMA, Congress clearly sought to avoid a royalty accounting and collection system operating entirely on the honor principle, with no verification of production and sales data, since this sort of arrangement had led to underreporting of production and sales in the past. See H.R. Rep. No. 859, 97th Cong., 2d Sess. 15, 16 (1982), reprinted in 1982 U.S. Code Cong. &

Admin. News 4269-70. Instead, the statute required the Secretary and his delegates to audit and reconcile lease accounts. Congress, however, was also aware that "auditing every account on an annual basis is clearly impractical." H.R. Rep. No. 859, 97th Cong., 2d Sess. 33 (1982), reprinted in 1982 U.S. Code Cong. & Admin. News 4287. With this practical consideration in mind, the Secretary was to audit and reconcile accounts only "to the extent practicable." 30 U.S.C. § 1711(c)(1) (1994). See Texaco Exploration & Production, Inc., 134 IBLA 267, 269 (1995).

In BHP Petroleum (Americas) Inc., 124 IBLA 185, 187 (1992), we held that FOGRMA does not restrain the Secretary from directing a royalty payor to review royalty accounts in order to unearth underpayments traceable to an identified defect in the payor's original computation of royalties due. We also approved MMS' practice of sampling certain leases or production months, leaving the payor the burden of uncovering all other instances of systemic deficiency. Id. at 188; see also Texaco Exploration & Production, Inc., 134 IBLA at 269-70; Amoco Production Co., 123 IBLA 278, 281-84 (1992).

Furthermore, the court in Phillips Petroleum Co. v. Lujan, 963 F.2d 1380, 1386 (10th Cir. 1992), specifically rejected Phillips' argument that MMS had required it to perform an impermissible "self-audit" in contravention of FOGRMA. The court approved MMS' procedure of requiring lessees to correct repeated royalty underpayments caused by systemic deficiencies, finding that such a request "falls squarely within the purposes of the FOGRMA." Id.

Although price fluctuations, without more, might not suffice to establish systemic errors, the evidence discovered by MMS in its review concerning the understatement of natural gas sales quantities and the application of incorrect royalty rates disclosed irregularities that were capable of repetition. See Texaco Exploration & Production, Inc., 134 IBLA at 270; Amoco Production Co., 123 IBLA at 294. Thus, ample justification exists for the MMS demand.

We further find that FOGRMA does not limit MMS' authority to require Texaco to submit workpapers and schedules demonstrating compliance with the recalculation order. That statute provides that MMS may, in conducting "any investigation \* \* \* require by special \* \* \* order, any person to submit in writing such \* \* \* answers to questions as [MMS] may reasonably prescribe." 30 U.S.C. § 1717(a)(1) (1994). As we noted in Amoco Production Co., 123 IBLA at 285, the purpose of FOGRMA was to enhance and expand the investigatory powers of the Secretary and MMS. We conclude that MMS is authorized to require the preparation and submission of the requested documents under 30 U.S.C. § 1717(a)(1) (1994). See Phillips Petroleum Co. v. Lujan, 951 F.2d 257, 260 (10th Cir. 1991); BHP Petroleum (Americas) Inc., 124 IBLA at 189.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

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David L. Hughes  
Administrative Judge

I concur.

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C. Randall Grant, Jr.  
Administrative Judge

